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In The
Supreme Court Of The United States
October Term, 2000

JEFFREY N. MEHLER AND MARY S. RUSSELL,
Petitioners

v.

THE TERMINIX INTERNATIONAL COMPANY, L.P.,
Respondent

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF AMICI CURIAE OF THE STATE OF CONNECTICUT, FOUR STATES AND THE COMMONWEALTH OF PUERTO RICO IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST

The *amici curiae* State of Connecticut and the states identified on the cover, by and through their attorneys general, respectfully submit this brief in support of the Petition for Writ of Certiorari of Jeffrey N. Mehler and Mary S. Russell.

The States have a strong interest in preserving the proper balance of power between federal and state governments. Our system of federalism, as explained by Justice Black,

> ...is a system in which there is sensitivity to the legitimate interests of both State and National Governments, and in which the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the States.

Younger v. Harris, 401 U.S. 37, 44-45 (1971).

Specifically, the States' interest is in opposing unwarranted federal encroachment upon state law governing the formation and enforceability of contracts, an area traditionally left to state regulation. The States view the preservation of state contract law as necessary to the protection of their citizens from abusive and unconscionable business practices which result in the unknowing or coerced surrender of important legal and constitutional rights, including the right to a jury trial.

Section 2 of the Federal Arbitration Act[1/] (hereinafter "FAA") expressly reserves this role for the states as recognized by this Court. *Allied Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265, 281 (1995).

REASONS FOR GRANTING THE PETITION

I. THE SECOND CIRCUIT DISREGARDED PRINCIPLES OF FEDERALISM TO EFFECT AN UNAUTHORIZED PREEMPTION OF STATE LAW

The Second Circuit erroneously applied the federal presumption of arbitrability in a manner which preempts state contract law and violates established principles of federalism.

A. Federalism Maintains a Critical Balance of Power Between Federal and State Governments

Our system of federalism embodies a dual sovereignty in which the states possess sovereignty concurrent with the federal government, subject only to the limitations imposed by the Supremacy Clause. *Gregory v. Ashcroft*, 501 U.S. 452, 457 (1991). It is a system which strikes a careful balance between the legitimate interests of both the federal and state governments. *Younger*, 401 U.S. at 44-45. This constitutionally mandated balance of power was adopted by the original framers of the Constitution in order to preserve our fundamental liberties and as a check on the abuse of government power. *Gregory*, 501 U.S. at

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1/ 9 U.S.C. § 2

458-459 ("In the tension between federal and state power lies the promise of liberty."), *Atascadero State Hospital v. Scanlon,* 473 U.S. 234, 242 (1985).

B. Federal Power is Used to Preempt Areas of Traditional State Regulation Only Where Such Congressional Intent is Unmistakably Clear

While Congress has the authority, as long as it is acting within its defined constitutional powers, to preempt state law, it does not take this intrusion upon state authority lightly. *Gregory*, 501 U.S. at 460. This is true particularly in areas of traditional state regulation, such as the formation and enforceability of contracts, where this reluctance to encroach upon state powers is expressed as a judicial presumption against preemption. *California v. ARC America Corp.*, 490 U.S. 93, 101 (1989). Accordingly, federal legislation will be applied to preempt state law in such traditional areas of state regulation only if the Congressional intent to do so is "clear and manifest." *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544 (1994), *Gregory*, 501 U.S. at 461, *Atascadero*, 473 U.S. at 242-243.

C. The Second Circuit Disregarded Clear and Specific Congressional Intent to Preserve State Contract Law in Applying the FAA

A court cannot construe a federal statute to impinge on legitimate state interests without considering the effect of such a ruling on our federalist system. *BFP*, 511 U.S. at 544. It also is incumbent upon the federal courts to be

certain of Congressional intent before determining that federal law overrides the existing balance of federal and state powers. *Gregory*, 501 U.S. at 460, *Atascadero*, 473 U.S. at 243. If there is any doubt about Congressional intent, principles of federalism require that the federal courts defer to traditional state regulation. *BFP*, 511 U.S. at 546.

In determining the intent of Congress, the courts must look to the express language of the statute "and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose." *Morales v. TWA*, 504 U.S. 374, 383 (1992). "Preemption fundamentally is a question of congressional intent, and when Congress has made its intent known through explicit statutory language, the court's task is an easy one." *English v. GE*, 496 U.S. 72, 78-79 (1990).

Congressional intent in enacting § 2 of the FAA is unmistakably clear. This provision specifically preserves "such grounds as exist at law or in equity for the revocation of any contract" as a basis for invalidating arbitration clauses. Through this express language, Congress sought to limit its intrusion upon state authority and to carefully protect general principles of state contract law, an area historically regulated by the states. Accordingly, this Court has held that state contract law must be applied in determining whether there is a valid agreement to arbitrate the subject of a dispute. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995), *Allied Bruce*, 513 U.S. at 281, *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987).

The Second Circuit erroneously determined that the parties should have been required to submit their dispute to arbitration based on the FAA's presumption in favor of arbitrability, "irrespective" of the construction of the parties' contract pursuant to state law. Petitioners' Appendix 13. The Second Circuit's view that this principle of federal law preempts the application of traditional state contract law is contrary to the Congressional intent set forth in the express language of § 2 of the FAA and contrary to the well established principles of federalism.

II. THE ARBITRATION CLAUSE CANNOT BE ENFORCED TO RESOLVE THIS DISPUTE UNDER WELL SETTLED PRINCIPLES OF STATE CONTRACT LAW

A. The Contract Was Not In Effect at the Time of the Wrongful Conduct By Terminix and, Therefore, Did Not Apply to the Dispute

The construction of the Terminix Termite Protection Plan (Petitioners' App. 42-47) which contains the disputed arbitration clause is governed by well established principles of state contract law. A contract must be construed to effectuate the intent of the parties which, in turn, must be determined from a fair and reasonable reading of the written words contained in the document. Where the language of the contract is clear and unambiguous, the contract must be given effect according to its terms. *Southeastern Conn. Regional Resources*

Recovery Authority v. Dept of Public Utility Control, 709 A.2d 549, 555 (Conn. 1998), *Lawson v. Whitey's Frame Shop*, 697 A.2d 1137, 1141 (Conn. 1997), *24 Leggett Street Ltd. Partnership v. Beacon Industries*, 685 A.2d 305, 311 (Conn. 1996). Where the plain meaning and intent of the language is clear there is no room for construction.[2/] *Levine v. Massey*, 654 A.2d 737, 740 (Conn. 1995), *Collins v. Sears, Roebuck & Co.*, 321 A.2d 444, 448 (Conn. 1973). A court cannot disregard the words of the parties or read into a contract by interpretation, a provision which is contrary to the express terms of the agreement itself. *Pesino v. Atlantic Bank of New York*, 709 A.2d 540, 546 (Conn. 1998), *Levine*, 654 A.2d at 740-741, *Collins*, 321 A.2d at 448.

The subject of the parties' dispute is the damage caused by Terminix during the application of termiticide to the Petitioners' residence on July 19th and July 24th, 1996. The Termite Protection Plan (Petitioners' App. 42) was signed by the parties on July 19th while the initial treatment work had yet to be performed. By its terms the Termite Protection Plan is a conditional service contract and guarantee which provides for future inspections and treatments for termite infestation and guarantees against future damage from such infestations. It contains a notice

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2/ Even if the contract language were deemed ambiguous, it also is well established that, particularly in the case of form contracts, any such ambiguity must be construed against the interests of the drafting party, in this case, Terminix. *Streitweiser v. Middlesex Mutual Assurance Co.*, 593 A.2d 498, 500 (Conn. 1991).

that the agreement is contingent upon approval of the Terminix manager and that confirmation of the effective date will be forwarded after completion of the work and payment has been received.

Subsequent to the completion of the termite treatment work a written confirmation (Petitioners' App. 47) was issued by Terminix which identified the contract by number and stated that it began on August 1, 1996. These documents must be read together in determining the intent of the parties. *Mongillo v. Commissioner of Transportation*, 571 A.2d 112, 115 (Conn. 1990).

Since the damage which is the subject of the parties' dispute occurred during the application of the treatment in July and the contract expressly states that the contract does not begin until August 1, 1996, the contract does not apply to the dispute. Contrary to this explicit language, the Second Circuit reads into the contract a provision which makes the contract effective on July 19th. The Second Circuit's reading also renders superfluous the express contract language which creates certain conditions precedent. The completion of the treatment work, receipt of payment and managerial approval all had to be fulfilled before the contract could become effective and none had occurred on July 19th. The Second Circuit's tortured reading of the contract to import a new effective date is contrary to the express terms of the agreement and violates the fundamental state law principles of contract construction previously discussed.

B. The Arbitration Clause in the Termite Protection Plan is Unconscionable Under State Law

Connecticut courts have established that unconscionability, as a defense to the enforceability of a contract, is determined as a question of law, based on all of the relevant facts and circumstances of the case. *Cheshire Mortgage Service, Inc. v. Montes*, 612 A.2d 1130, 1135 (Conn. 1992); *Iamartino v. Avallone*, 477 A.2d 124, 128 (Conn. 1984). The purpose of the doctrine is to prevent oppression and unfair surprise. *Family Financial Services, Inc. v. Spencer*, 677 A.2d 479, 484 (Conn. 1996) (citing J. Calamari & J. Perillo, Contracts (3d Ed.) § 9-40). In determining whether contractual provisions are unconscionable, the courts have been guided by the principles set forth in Official Comment 1 to § 2-302 of the Uniform Commercial Code.

> The basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.

Hamm v. Taylor, 429 A.2d 946, 949 (Conn. 1980).

In this case, the plaintiffs are ordinary consumers, trying to maintain and preserve their home, with no particular expertise regarding the application of termiticide or termite service plans. The Termite Protection Plan is a preprinted form. While the front of the form contains the

signatures of the parties, the arbitration clause is located on the back of the form near the bottom of the page. (Petitioners' App. 43). Terminix would not have agreed to apply the termiticide if Mr. Mehler had not signed the Termite Protection Plan. The Terminix Inspection Graph (Petitioners' App. 44) showed that there was an ongoing termite infestation which had already caused damage to the residence. No other company contacted by Mr. Mehler would perform the necessary work. It is clear that Mr. Mehler had no meaningful opportunity to negotiate the terms of the standardized arbitration clause and had no choice but to sign the agreement. This is a typical contract of adhesion. See, *Aetna Casualty and Surety Co. v. Murphy*, 538 A.2d 219, 222 (Conn. 1988).[3/]

The terms of the arbitration clause are oppressive and unfairly surprise consumers. The clause does not set forth any of the arbitration procedures to be followed when a dispute arises, but merely incorporates by reference, the Rules of Commercial Arbitration of the American Arbitration Association. The significance of this reference may be understood by business persons who regularly enter into such contracts, but not by ordinary consumers.

3/ In the case of consumer adhesion contracts, the presumption of arbitrability should not be routinely applied since there is doubt that a true agreement to submit issues to arbitration ever existed. Such arbitration clauses should be more closely scrutinized by the courts. *Williams v. Aetna Finance Co.*, 700 N.E.2d 859, 867 (Ohio, 1998); *Patterson v. ITT Consumer Financial Corp.*, 18 Cal. Rptr. 2d 563 (Cal. App. 1st Dist. 1993).

1. Waiver of right to jury trial

The arbitration clause is unconscionable because it results in the unknowing waiver of the Mehlers' right to a jury trial. In *L&R Realty v. Connecticut National Bank*, 715 A.2d 748, 755 (Conn. 1998), the court held that a jury trial waiver entered into in advance of litigation was enforceable only when there is clear evidence of an intent to waive that right.

The holding in *L&R Realty* did not specifically involve an arbitration clause, but rather, sets forth a principle of general applicability to any contracts which purport to waive this fundamental constitutional right. These factors were applied in *Norton v. Commercial Credit Corp.*, No. 98-0578441, 1998 WL 729700 (Conn. Super. Ct. Oct. 6, 1998) to invalidate an arbitration agreement which made no reference to the waiver of access to the courts or the right to a jury trial. The arbitration clause in the Terminix service plan, by failing to provide any notice whatsoever that consumers are waiving their right to a jury trial, unfairly surprised the Mehlers and is oppressive.

2. Access to the forum conditioned upon payment of an excessive filing fee

The Petitioners had no prior notice that the submission of a dispute to arbitration was conditioned upon the prepayment of a substantial fee. In this case, the fee to file the Mehlers' claim would be $7,000.00, exclusive of the AAA administrative fee and the arbitrator's daily fee.

Letter of November 26, 1997 from Martha Dean to Laura McNaughton, AAA Administrator (Petitioners' App. 80).

Such a financial burden, especially without effective prior notice, may deprive a party of access to the arbitral forum. In essence, the arbitration clause, by its terms, prohibits consumers from seeking redress through the judicial system, and then renders the arbitral forum inaccessible. In *Myers v. Terminix Int'l Co.*, 697 N.E.2d 277 (Ohio Ct. Com. P. January 27, 1998), the court struck down as unconscionable, a Terminix arbitration clause which is essentially the same as that found in the Mehlers' service plan. A similar clause was held to be unenforceable by the courts in both the *Patterson* and *Williams* cases, and in *Shankle v. B-G Maintenance Management of Colorado, Inc.*, 163 F.3d 1230 (10th Cir. 1999).

III. IN CASES SUCH AS THIS, WHERE THERE IS NO MEANINGFUL CONSENT, THE IMPOSITION OF A MANDATORY ARBITRATION CLAUSE VIOLATES THE PUBLIC POLICY OF THE FAA

A. Federal arbitration policy is based on the enforcement of arbitration agreements which are voluntary

The central purpose of the Federal Arbitration Act, 9 USC § 1, et. seq., is to ensure that "private agreements to arbitrate are enforced according to their terms." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) (quoting *Volt Information Sciences, Inc. v.*

Board of Trustees of the Leland Stanford Junior University, 489 U.S. 468, 479 (1989)). It was specifically enacted to overcome judicial hostility to private agreements to arbitrate and the long standing rule in equity which refused to enforce such agreements. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219, 220 n. 6 (1985) (quoting HR Rep. No. 96, 68th Cong., 1st Sess. 1-2, (1924)); *Southland Corp. v. Keating*, 465 U.S. 1, 12-14 (1984). Congressional intent was to place arbitration agreements on the same footing as other contracts. *Volt*, 489 U.S. at 474; *Byrd*, 470 U.S. at 219.

While federal policy recognizes that arbitration can be an expeditious means of dispute resolution, "this policy does not operate without regard to the wishes of the contracting parties." *Mastrobuono*, 514 U.S. at 57. The consent of the parties has always been the cornerstone of the FAA. It does not mandate the arbitration of all claims but merely the enforcement of privately negotiated arbitration agreements.[4/] *Volt*, 489 U.S. at 474, 475; *Byrd*, 470 U.S. at 219-221 (the expeditious resolution of claims

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4/ See 9 USC § 3 (on application of a party to an arbitration agreement court may stay federal court proceeding "upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration *under such agreement*" (emphasis added)); 9 USC § 4 (on application of a party to enforce an arbitration agreement court may issue an order "directing that such arbitration proceed *in the manner provided for in such agreement*" (emphasis added)).

was deemed to be secondary to the Act's purpose of protecting the contractual rights of the parties).

> After all, the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, ...but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms ....and according to the intentions of the parties ...."[citations omitted].

First Options of Chicago, Inc., 514 U.S. at 947. "Arbitration under the Act is a matter of consent, not coercion." *Mastrobuono*, 514 U.S. at 57, (quoting *Volt*, 489 U.S. at 479).

The element of consent was considered so crucial to the FAA that adhesion contracts, in which the voluntariness of the weaker party might be called into question, were thought to be entirely exempt from the coverage of the Act. Justice Black described the view expressed by certain members of Congress at that time:

> On several occasions they expressed opposition to a law which would enforce even a valid arbitration provision contained in a contract between parties of unequal bargaining power. Senator Walsh cited insurance, employment, construction, and shipping contracts as routinely containing arbitration clauses and being offered on a take-it-or-leave-it basis to captive customers or employees. He noted that such contracts "are really not voluntarily [sic] things at all" because "there is nothing for the man to do except to sign it; and then he surrenders his right to have his case tried by the court ...." He was emphatically assured by the

> supporters of the bill that it was not their intention to cover such cases.

Prima Paint Corp. v. Conklin, 388 U.S. 395, 414 (1967) (Dissenting opinion, citing to Hearing on S 4213 and S 4214 before the Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess., 9-11 (1923) and to Joint Hearings on S 1005 and HR 646 before the Subcommittees of the Committees on the Judiciary, 68th Cong., 1st Sess., 15 (1924)).

B. Mandatory binding arbitration lacks sufficient safeguards to protect the rights of consumers in the absence of meaningful consent

As this Court has previously observed, "the choice of forums inevitably affects the scope of the substantive right to be vindicated." *Alexander v. Gardner-Denver Company,* 415 U.S. 36, 56 (1974) (quoting *U.S. Bulk Carriers v. Arguelles*, 400 U.S. 351, 359-360 (1971)(Harlan, J., concurring)). In certain instances, this Court has found that the arbitral forum, because it is less protective of individual statutory rights, cannot provide an adequate substitute for the judicial process. *McDonald v. City of West Branch*, 466 U.S. 284 (1984) (§ 1983 actions), *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981) (Fair Labor Standards Act claim), *Alexander v. Gardner-Denver Company,* 415 U.S. 36 (1974) (Title VII action).

An arbitrator may have expertise in the operation of a particular business or in a specific commercial subject

area but that does not guarantee the level of expertise required to resolve the complex legal issues that may arise in certain statutory actions. *McDonald*, 466 U.S. at 290, *Gardner-Denver*, 415 U.S. at 57. Some statutory questions can only be resolved upon review and consideration of volumes of legislative history and decades of administrative and legal rulings. *Barrentine*, 450 U.S. at 743. Even if the arbitrator has the knowledge to analyze complicated statutory legal claims, in most instances, he does not have the authority to do so since his authority is limited by the contract itself. If the arbitrator were to base his decision upon the requirements of the law rather than solely on the provisions of the contract, he would have exceeded the scope of his authority and the award would not be enforced. When there is a conflict between the rights guaranteed by statute and the provisions of the contract, the arbitrator must enforce the contract. *McDonald*, 466 U.S. at 290-291, *Barrentine*, 450 U.S. at 744, *Gardner-Denver*, 415 U.S. at 57.

> Moreover, the fact finding process in arbitration usually is not equivalent to judicial fact finding. The record of the arbitration proceedings is not as complete; the usual rules of evidence do not apply; and rights and procedures common to civil trials, such as discovery, compulsory process, cross-examination, and testimony under oath, are often severely limited or unavailable ....and arbitrators have no obligation to the court to give their reasons for an award.

Gardner-Denver, 415 U.S. at 57-58.

Lastly, arbitrators are often powerless to grant a broad range of relief, once again because their authority is limited by the terms of the contract. This may likely result in the exclusion of certain categories of damages, costs and attorneys fees[5]. *Barrentine*, 450 U.S. at 744.\

In *Gardner-Denver* and its progeny this Court has refused to impute a consensual waiver of access to the judicial process where important statutory rights are involved, merely by submission of a dispute to arbitration. This is due at least in part to the inadequacy of arbitration procedures under the FAA to protect those rights. It is also clear that in such arbitration proceedings, the contract controls the scope of the issues and the power of the arbitrator. Whoever controls the contract controls the arbitration proceeding.

These reasons illustrate the dangers of arbitration clauses contained within preprinted form contracts of adhesion in consumer transactions such as the Petitioners'. Arbitrators familiar with the legal principles of commercial arbitration may have no familiarity with specific consumer protection statutes. Some consumer protection statutes, such as state unfair trade practices acts, are purposefully broad and cannot be interpreted or applied without reference to decisions of the Federal Trade Commission and an extensive body of administrative and judicial decisional law. The application of these remedial statutes,

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[5] The Terminix arbitration clause in this case excludes "indirect, special or consequential damages or loss of anticipated profits." Petitioners' App. 43.

often designed to level the marketplace between parties of unequal bargaining power, may be severely limited or even avoided by a well drafted arbitration clause, precisely because of the superior bargaining power of the business drafting the form contract.

To the extent that contract clauses purportedly waive statutory claims and remedies the arbitrator must give effect to the contract over the application of the consumers' statutory rights. If a contract does allow for the application of law by the arbitrator, and he misinterprets or incorrectly applies the law, there is no remedy for the disadvantaged party. Judicial review is extremely limited by the itemized grounds set forth in 9 U.S.C. § 10. It is well settled that errors of law are not a basis for vacating an arbitration award under the FAA.[6/] In fact, since the arbitrator is under no obligation to state the reasons for the award, meaningful judicial review of whether the arbitrator incorrectly applied the law, or ignored it altogether, is virtually impossible.

Lastly, since the arbitrator is limited to awarding the remedies in the contract, the business drafting a form

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6/ See, e.g., *Flexible Mfg. Systems Pty. Ltd v. Super Products Corp.*, 86 F.3d 96 (7th Cir. 1996) (arbitrator's mistake in rejecting valid legal defense insufficient to vacate award), *Advest, Inc.v. McCarthy*, 914 F.2d 6 (1st Cir. 1990), *O.R. Securities, Inc. v. Professional Planning Associates, Inc.*, 857 F.2d 742 (11th Cir. 1988), *Saxis Steamship Co. v. Multifacs Intl. Traders, Inc.*, 375 F.2d 577 (2d Cir. 1967).

contract may preclude consumers from obtaining the full range of remedies otherwise available under the law.

CONCLUSION

For all of the foregoing reasons the State of Connecticut and the States named herein respectfully request that the Court grant the Petitioners' Request for a Writ of Certiorari.

Respectfully submitted,

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